Lecture 8: Accounting Transaction Cycles

Learning Objectives

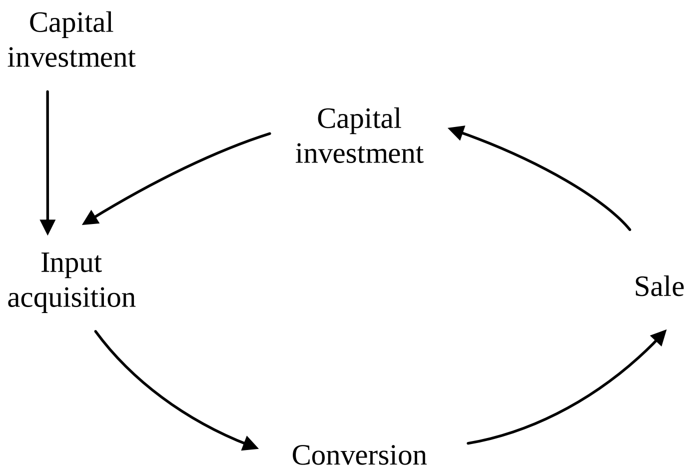
1. To recognize those economic activities in which all organizations engage.
2. To understand how economic events are recorded as accounting transactions.
3. To find out the transactions cycles that make up an accounting transaction processing system.
4. To learn the application systems constituting each transaction cycle.

Transaction cycles emphasize the continuous nature of all business and accounting processes and demonstrate how events early in transaction cycle affect events and records alter in the cycle.

The Cycle of Business Activities

Even though business differs in their operations, all of them engage in a cycle of business activities. Each activity has certain economic events common to most; these economic events produce accounting transactions that must be processed by the accounting system. Illustration 8.1 summarizes these basic business activities.

Illustration 8.1: The Cycle of Basic Business Activities



Source: BOOCKHOLDT, J.L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

1. Capital Investment concerns acquiring money from owners or creditors to generate products or services and produce revenue. It comprises two significant economic events – raising capital and using capital to acquire productive assets.

2. Input Acquisition is concerned with the acquisition of materials and overhead. The activity of input acquisition has four economic events: ordering of inputs, receiving them, recording an obligation to pay for them and paying for them.

3. Conversion of inputs into salable goods or services. One economic event taking place during conversion is the consumption of labor, materials and overhead to produce a salable product or service.

4. Sales of the goods or services that were outputs of the conversion process. It consists of four economic events: receiving a customer order, delivering goods to the customer, requesting payment for the goods and receiving payment.

Analyzing the cycle of basic business activities reveals the origin of the transaction cycles that make up the accounting transaction processing system.

Transaction Cycles

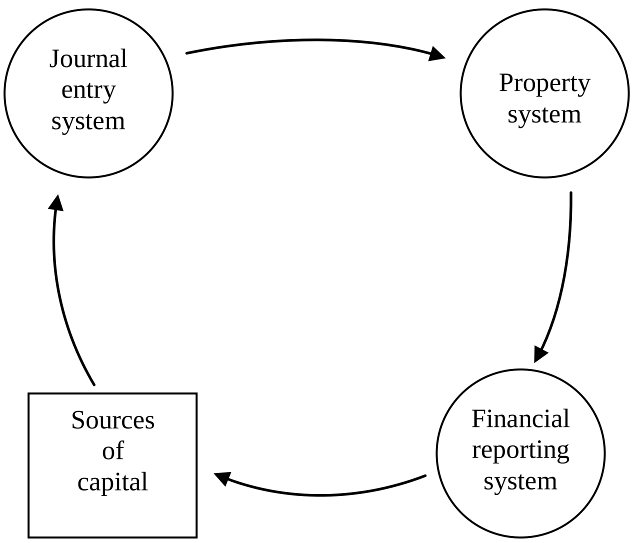
Transaction cycle is a set of accounting transactions occurring in normal sequence and used to record economic events.

Financial Cycle

The financial cycle includes the accounting transactions that record the acquisition of capital from owner and creditors, the use of that capital to acquire productive assets and report the owners and creditors on how it is used. → We identify 2 economic events in the financial cycle: raising capital and using capital to acquire productive assets. The third event is not really an economic one – it is periodic reporting to the sources of capital.

The three accounting application systems that record the events in the financial cycle are the *property*, the *journal entry* and the *financial reporting systems.*

Illustration 8.2: The Financial Cycle



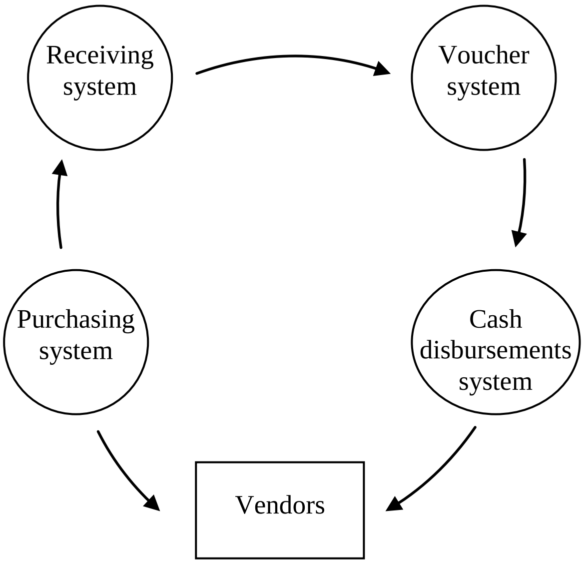
Source: BOOCKHOLDT, J.L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

Expenditure Cycle

The expenditure cycle consists of those transactions that record the acquisition of material and overhead items for the conversion process of the business. This cycle processes transactions representing these economic events: requesting the items, receiving the items, recording the obligation to pay for the items and paying for them.

The expenditure cycle consists of four application systems: *purchasing*, *receiving*, *voucher* and *cash disbursements systems*.

Illustration 8.3: The Expenditure Cycle



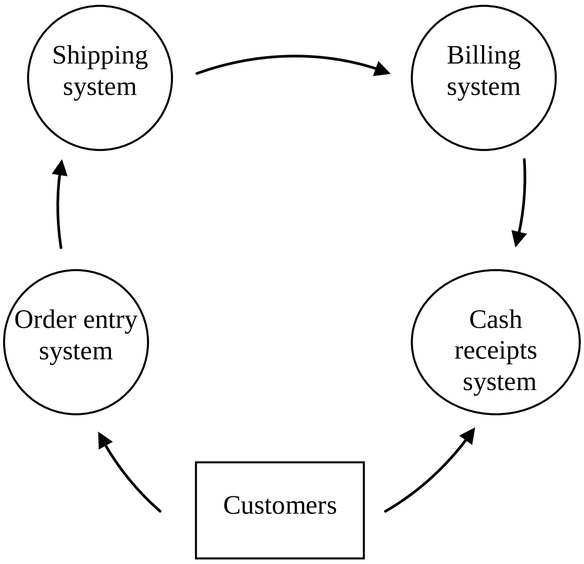
Source: BOOCKHOLDT, J.L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

Revenue Cycle

The revenue cycle includes the accounting transactions that record the generation of revenue from the outputs of the conversion process. These four economic events generate revenue: receiving an order from a customer, delivering goods to the customer, requesting payment for the goods and receiving payment.

The revenue cycle contains four application systems: *order entry*, *shipping*, *billing* and the *cash receipts systems*.

Illustration 8.4: The Revenue Cycle



Source: BOOCKHOLDT, J.L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

Conversion Cycle

The conversion cycle contains those transactions incurred when inputs are converted into salable goods or services. One economic event exists in this cycle - labor, materials and overhead are consumed in the conversion process.

Depending on the type of organization, the conversion cycle contains either two or three application systems. Manufacturing and service companies use the *cost accounting system* to record labor, material and overhead cost. All type of organization use the *payroll system*. Manufacturing and merchandising companies us the *inventory system* to maintain records of inventory on hand.

Lecture 8 - Questions and exercises

E 8-1: Economic events

The left column below contains transaction cycles. In the right column are economic events common in organizations.

a) Revenue	1. Request inputs to production.
b) Expenditure	2. Deliver goods to customer.
c) Conversion	3. Raise capital.
d) Financial	4. Use property in production.
	5. Recognize obligation to pay.
	6. Receive request from customer.
	7. Consume material and labor.
	8. Give periodic reports.
	9. Receive inputs to production.
	10. Receive payment from customers.

Required:

Match each economic event with the transaction cycle to which it belongs.

E 8-2: Transaction cycles

Draw and describe one of the transaction cycles.

The main source:

BOCKHOLDT, J. L. *Accounting Information Systems: transaction processing and controls.* 5th edition, Boston: McGraw Hill Education 1999, ISBN 0-07-116098-1

The supplementary sources:

CAREY, M., KNOWLES, C. *Accounting: A Smart Approach*. 1st edition, New York: Oxford University Press, 2011, ISBN 978-0-19-958741-4

GELINAS, U. J., DULL, R. B. *Accounting Information Systems.* 8th edition, Mason: Cengage Learning, 2010, ISBN 978-0-324-66380-8

HALL, J. A. *Accounting Information Systems.* 7th edition, Mason: Cengage Learning, 2010, ISBN 978-1-4390-7857-0